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JAPAN-KOREA ECONOMIC RELATIONS

Summary

South Korea's relationship with Japan has always been shaky and has only recently begun to improve. In spite of occasional anti-Japanese outbursts, the two countries are moving in the direction of closer economic and political ties. as illustrated by Japan's commitment to provide Korea with a $4-billion aid package. The August ministerial talks in Tokyo were described by Japanese officials as the most constructive effort yet achieved by the two countries. This paper will analyze the bilateral relationship and discuss as well the role played by the United States in the Far East.

Trade and Investment

In 1982, Japan's exports to Korea dropped to $4.9 billion, 14 percent under the previous year; imports fell by 4 percent to $3.25 billion, leaving Japan with a trade surplus of $1.63 billion.[1] Korea is Japan's fourth-largest export market, buying 3.5 percent of total shipments, and supplying 2.5 percent of Japan's total imports. Last year, Korea's increasingly competitive steel and shipbuilding capacities trimmed imports from Japan, while stagnation in world trade further contracted Seoul's purchases of heavy machinery and industrial chemical products. More than 70 percent of Japan's imports from Korea consisted of manufactured products, particularly textiles and apparel, which declined along with machinery and chemical products. Only steel imports recorded a 14-percent increase.

Japan's direct overseas investment in Korea reached $1.3 billion in March 1983, although in the last several years a number of Japanese firms have withdrawn from the market and new capital outlays have been drastically cut because of Korea's tax and export requirement systems. These developments led Korean officials at the recent ministerial talks in Tokyo to press for expanded investment, particularly in heavy industry.

Korea's Domestic Economy

Korea's scarce resources force the country to import 75 percent of its total energy consumption and 55 percent of its food supplies. The government has followed policies that offer incentives for exporters and curbs on imports, while also attempting to move from light manufacturing to heavy and chemical industries.

With the economy recovering, the Bank of Korea showed real growth at 9.6 percent for January-June 1983, compared with 5.4 percent in 1982.[4] While last year's growth was due primarily to government fixed investment and private sector demand, exports are now bouncing back. June's totals jumped 26 percent over year-earlier figures, followed by another 34-percent increase in July. Shipments to the United States and the Middle East led the increase. Steel, textiles and wood products remain sluggish, but electronics, shipbuilding and consumer products continue to be strong. Wholesale prices in June declined, bringing consumer price inflation down from 21 percent in 1981 to 7.3 percent in 1982. Assuming that stable oil prices continue, officials are confident that the economy will take off in 1983.[5]

Korea's postwar economic success has been spectacular. With per-capita income of $1,636, the country ranks near the top of the newly industrializing countries. Knowledge, skills and a favorable international trade environment, combined with access to foreign technology and massive foreign aid have contributed to this performance. Controversial but stable political leadership has sustained economic growth at a high rate.[6]

Even so, the country faces very high levels of foreign debt — the largest in Asia and the fourth largest in the world. By the end of 1982, foreign debt amounted to $37.3 billion. Between January and June of this year, it increased by $874 million. While Korea's credit rating is high because of its highly competitive export industries and economic policy record, the debt buildup is worrisome for the government. It has been reported that the government intends to reduce the debt by cutting down drastically on the number of development projects — from $9.1 billion to $3 billion — and will also make a determined push for buy-Korea procurement and tight limits on overseas borrowing.[7]

Without any oil resources of its own, Korea, like Japan, imports all its oil — 90 percent of it from Saudi Arabia. Almost 80 percent of all electric power is oil-generated. The government is presently trying to rationalize its energy supplies to forestall a repeat of the two oil crises which resulted in rampant inflation, low growth and a widening current-account deficit.[8]

Korea's protectionist trade policies have also come under fire, although it has not yet become as serious an international issue as in the case of Japan. In response, the government is moving slowly to lift import restrictions. In June 1982, an increase in the level of automatic import approvals was announced and the number of items that had been prohibited was reduced somewhat. Import embargoes will be lifted in favor of tariffs, and by next year tariff cuts on more than 700 imported items will be in place. At the same time, however, the government also will impose temporary "tariff coordination taxes" of up to 100 percent in order to prevent a massive flow of imports.[9]

The implications of Korea's closed market were addressed by U.S. Ambassador Richard Walker in Seoul recently. Ambassador Walker warned Korean exporters not to "target" the U.S. market as their destination and to open markets to imports from abroad. He urged the government to continue to liberalize foreign investment policy and to

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correct inadequate patent protection in order to accommodate technology licensing to Korean firms.[10]

Bilateral Relations

Typically, the government and the ruling Liberal Democratic Party (LDP) have pursued a close political relationship with Korea within the broad context of security in the Far East. The opposition parties and the press have tended to attack contacts between the establishment and what they assert is a military dictatorship in Korea. Korea's strong anti-Japanese sentiments are rooted in pre-1945 Japanese colonial rule and compounded by discrimination against Korean residents in Japan and a disproportionate Japanese economic presence in Korea. There has been a sharp split among Japanese opinion leaders on the role of the military in Korea, human rights, and the bilateral relationship's impact on security in the Korean peninsula.

With the death of President Park and General Chun Doo Hwan's election in 1981, the bilateral relationship has taken a more structured course. Since 1965, Korea has run a trade deficit with Japan and has been unhappy about import restrictions on raw silk and silk fabrics. Korean fishing boats in Japanese territorial waters occasionally pose diplomatic problems. From time to time, there are protests over the Korean occupation of Takeshima Island, which is claimed by Japan. The most heated controversy recently involved charges that the Japanese government was attempting to distort history by editing the textbooks describing Japan's actions before and during World War II. The issue was finally settled, but sentiments ran high.

Economic Aid

Japan's official development assistance to Korea reached a cumulative total of ¥627 billion ($2.6 billion) by the end of 1982.[2] Loans have been extended for agriculture, power supply projects, and health and educational facilities. More than 6,000 Koreans have been trained in Japan, while over 1,000 Japanese technicians have provided sectoral expertise and the private sector has agreed to defer payments on a cumulative total of $3.5 billion in exports.[3]

In 1981, after a three-year lapse, talks were held in Seoul, at which time Korea requested a $6-billion aid package, stressing that it considered such assistance a tradeoff for Korean security efforts in the Far East. Japan rejected both the amount and the philosophy. A breakthrough came in early 1983 when Prime Minister Nakasone visited Seoul, the first postwar Japanese prime minister to do so. Agreement was reached on a $4-billion aid package spread over seven years, and in August the foundations of the expanded economic cooperation program were outlined (see JEI Report No. 35B, September 16, 1983).

Characteristics

There is little dispute that historical prejudices have hampered a constructive bilateral relationship. The prewar generation in Korea is not friendly to Japan; the postwar generation associates Japan with the repressive colonial experience taught in school and at home. Elderly Japanese harbor negative ethnic and cultural prejudices against Koreans, although the younger generation is often indifferent. Characteristically, cross-cultural communications suffer both from Japan's ignorance of Korea and Korea's obsession with Japan. An easing of tensions can be anticipated as younger policymakers in both countries begin to balance the practical implications of friendship on regional economic and security policies. This adjustment has actually begun as younger Koreans, many of whom were educated in the United States, have begun to enter the government.

Interestingly, their detachment, while desirable from a political point of view, has undermined the dominance of old "Korea hands" in Tokyo, creating a gap in communications. The change, though as the Japanese press has pointed out, might be a blessing since the traditional approach generated speculation about corruption.

Korea's Foreign Policy

Perhaps the most troublesome bilateral problem is Japan's North Korea policy. For political reasons, the Korean government wants Japan to limit contacts with the North Koreans. Prime Minister Nakasone has said, however, that Tokyo's close relationship with South Korea would not prevent unofficial contacts with North Korea. Both Koreas have been attempting to isolate each other from the international community and win support. Under President Chun's leadership, South Korea continues to emerge as the stronger of the two. As a symbol of its international position, Korea will host a series of international conferences beginning this fall, including the International Parliamentarians' Union, the International Monetary Fund in 1985 and the Olympics in 1986. Whether communist representatives including North Korea will visit Seoul on these occasions is unknown. When Soviet officials recently attended an international conference in Seoul, North Korea reacted sharply. Diplomatic relations took a turn for the better when a highjacked Chinese plane landed in Korea and officials succeeded in persuading China to use the formal "Republic of Korea" in addressing the document. President Chun himself has vigorously cultivated foreign contacts, visiting Washington, the ASEAN nations and Africa. Scheduled for the fall are trips to Burma, India, Sri Lanka, Australia and New Zealand. Korea's top priority is a close defense pact with the United States. The security treaty with more than 50,000 U.S. troops stationed on Korean soil hammers home the message to North Korea, China and the Soviet Union.

Notwithstanding Japanese criticism of Korea's politics, common interests will increasingly hold the relationship together. While Japan is uneasy about the notion that Korea is actually buttressing Japan against communist aggression, Tokyo agrees that Seoul needs economic assistance. Japanese policymakers remain convinced that economic progress in the developing countries is vital. Their goal is to reinforce political stability and build a strong flow of trade.

So far as Tokyo is concerned, though, Korea's economic success poses a dilemma; if the strategy succeeds, the results hold some negative consequences for Japan. Korea's international competitiveness will threaten Japanese market dominance in certain products. The two countries' conditions are very similar. Both lack resources, rely on manufactured exports, and count on trading companies for a large role in the conduct of trade. Korea's construction and shipbuilding industries in a short period of time have become internationally competitive and in the shift from light manufacturing to more upscale technologies, it is clear that Korea is also aiming to export these goods. Requests for Japanese technologies reinforce the concerns of the Japanese business community.

The steel industry is cited as an example: In 1977, steel exports to Korea were more than 1.5 million tons; imports were 24,000 tons. After Japanese-assisted construction of a large steel mill in Pohang, steel exports to Japan began to increase and by 1982 exceeded Japan's shipments by almost half a million tons. Pohang's expansion, which has begun recently, will fuel apprehensions. Nihon Keizai Shimbun reported in August that Japanese steel firms were asked by Korea to provide technological assistance but rejected the request for fear that Korean steel products would flood Japan. They were also concerned that American makers would accuse Japan of assisting Korea's export thrust.

Japan's position as an industrially advanced nation with the second largest GNP in the free world is not endangered for the time being, but increasing competition from the newly industrializing nations will put less-competitive Japanese industries in trouble. Already, Korean-made apparel is dominant in the Japanese market, forcing Japanese manufacturers to seek a niche in the high quality, high-technology segment of the market. There are no signs that the Japanese government will actually impose protectionist measures against these imports, but the resolution of specific issues in many instances will be controversial. Whether individual trade issues escalate into political problems will depend on the stability of the relationship. Considering the emotional constraints, it will be difficult to separate economic and political issues. Just as in Japan's relationship with the United States, foreign economic policy will reflect domestic politics, and it is vital that both countries be well informed at all levels. Considering the paucity of information on Korea the public has acquired thus far, Japanese initiatives to understand Korea are more urgent.

U.S.-Japan-Korea Triangle

In considering the relationship between Japan and Korea, one cannot ignore the shadow of the United States. The security treaties with Japan and Korea are both designed to secure peace in the region. But Japan and Korea are not bound by a similar treaty. As a result, what the United States expects also affects the Japan-Korea relationship. U.S. demands that Japan improve its defense buildup generate a reaction throughout Asia, but particularly in Korea. On the one hand, Koreans are weary of spending nearly 6 percent of GNP on defense, compared with just below 1 percent by Japan. This discrepancy is troublesome and it should be welcome news for Korea that the United States is pressing Japan on this matter. Japan seems to be responding, particularly since Mr. Nakasone assumed office last fall, but at the same time, Korea is suspicious about Japan's potential military strength. As a result, Korean officials seem ready to accept Japan's defense buildup only up to a point, and with the qualification that the United States has control over Japanese intentions.

From the Japanese point of view, the United States is also expected to control the Korean leadership on the human rights issue. Consequently, whenever incidents such as the Kim Dae-Jung affair occur, the Japanese government and press pay close attention to actions taken by the United States. Japanese are divided between criticism of the military leadership and support for a stable government in Korea.

Economically, there is a curious similarity between the U.S.-Japan relationship and the Japan-Korea relationship. Just as Japanese exports have prompted criticism of targeting by Americans and led to protectionist moves in the Congress, Japan now finds itself in a similar position. While not seriously threatened by Korea's economic progress, Japanese businesses feel the heat. The catch-up syndrome is affecting Korea, too. Business Korea wrote that "Mainland China, long ignored as an underdeveloped country in semi-seclusion, until a few years ago mainly preoccupied with feeding its vast population of one billion, has emerged, with its spear ready, to engage in the world market as a strong competitor against Korea's industries, particularly in its main export markets of Japan, Hong Kong and the U.S."[11]

Japan's approach to Korea at one time was built around direct investment based on the advantages of lower wages. The acceleration of the wage scale, however, and the restructuring of tax breaks on certain foreign investments have led many Japanese firms to retreat. The Korean government is eager to attract foreign investment, particularly in the high-technology sector, and the investment laws will be a major issue between the

two countries. American investment has been substantial, too, and both nations want to see a rapid liberalization of foreign investment regulations.

At the political, economic and security levels, then, the three countries seek to deal mutually with major issues, but the relationship is deeply affected by U.S. strategy in the Far East, Japanese economic power and tensions over North Korea.

Footnotes

[1]Ministry of International Trade and Industry (MITI), White Paper on International Trade (Tsusho Hakusho), 1983, pp. 277-285 (in Japanese). See also Tables 2 and 3.

[2]MITI, White Paper on Economic Cooperation, (Keizai Kyoryoku no Genjo to Mondaiten), 1982, pp. 332-338 (in Japanese).

[3]Ibid.

[4]Nihon Keizai Shimbun, August 19, 1983 (in Japanese).

[5]"Government to Revise 5th 5-Year Economic Plan," Korea Trade and Business, August 1983, p. 4

[6]Glenn A. Lehman, "Korea's Postwar Economic Miracle: A Review," Korea's Economy, July 1982.

[7]Nihon Keizai Shimbun, August 27, 1983 (in Japanese).

[8]Anthony Geber, "Korean Energy and the Economy: Past, Present and Future," Korea's Economy, August 1982.

[9]Nihon Keizai Shimbun, August 27, 1983 (in Japanese).

[10]Business Korea, September 1983, p. 37.

[11]Ibid, pp. 43-47.

For further information, contact Fumiko Mori.

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Table 1: Key Economic Indicators of the Republic of Korea

	1981	1982	January-March 1982	April-June 1982	July-September 1982	October-December 1982
Growth of Real GDP	7.1%	5.3%	5.3%	1.8%	6.7%	5.4%
Agricultural Production	3.0	4.0	n.a.	n.a.	n.a.	n.a.
Industrial Production	10.0	4.5	5.7	2.7	2.7	5.3
Wholesale Prices	20.4	4.8	10.0	4.3	2.3	2.5
Consumer Prices	21.3	7.3	11.7	8.6	4.9	4.4
Balance of Payments (in millions of dollars)						
Current Account Balance	$-4,646	$-2,539	$-314	$-395	$-619	$-1,211
Trade Balance	-3,628	-2,400	-404	-389	-693	-914
Services (net)	-1,519	-618	-19	-118	-81	-400
Unrequited Transfers (net)	501	479	109	112	155	103
Long-term Capital (net)	3,637	1,943	560	69	1,170	144
Short-term Capital (net)	1,090	2,045	-255	656	-609	2,253
Errors & Omissions	-410	-1,444	-693	-268	-133	-350
Overall Balance	-329	5	-702	62	-191	836
Foreign Currency Reserves (end of period; millions of dollars)	2,695	2,820	2,841	2,567	2,604	2,820

Sources: Ministry of International Trade and Industry, White Paper on International Trade, 1983; International Monetary Fund, International Financial Statistics.

Table 2: Japan's Trade with the Republic of Korea, 1980-82

(in millions of dollars)

		Exports (f.o.b.)	Imports (c.i.f.)
1980		$5,368	$2,996
1981		5,658	3,389
1982		4,881	3,254
1982	June	433	253
	July	409	253
	August	384	279
	September	404	326
	October	422	291
	November	373	234
	December	491	240
1983	January	325	240
	February	396	208
	March	481	265
	April	491	268
	May	497	256
	June	540	264

Source: Japan Tariff Association, The Summary Report: Trade of Japan, June 1983.

Table 3: Japan's Trade with the Republic of Korea by Commodity, 1980-82

(in millions of dollars)

	1980	1981	1982	Percentage Change 1981-82
Exports				
Total	$5,368	$5,658	$4,881	-13.7%
Food	82	340	29	-91.4
Mineral Fuels	249	231	199	-13.8
Light Industrial Products	736	854	817	-4.3
Textiles	314	352	329	-6.8
Nonmetallic Mineral Products	97	107	132	23.5
Other	324	394	356	-9.7
Chemicals and Heavy Industrial Products	4,178	4,138	3,728	-9.9
Chemicals	838	841	780	-7.3
Metal Products	1,015	996	753	-24.4
Machinery	2,325	2,302	2,194	-4.7
Reexports	124	94	108	14.5
Imports				
Total	2,996	3,389	3,254	-4.0
Food	584	671	672	0.2
Industrial Supplies	189	111	114	2.3
Mineral Fuels	2	94	65	-30.7
Manufactures	2,182	2,478	2,363	-4.6
Chemicals	236	265	232	-12.6
Machinery	360	379	303	-20.2
Other	1,590	1,834	1,829	-0.3
Reimports	39	35	39	11.9

Source: Ministry of International Trade and Industry, White Paper on International Trade, 1983.